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June 3, 2003

BY HAND

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
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Washington, DC 20423-0001

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Re: Finance Docket No. 34342, *Kansas City Southern –
Control – The Kansas City Southern Ry., Gateway
Eastern Ry. & The Texas Mexican Ry.*

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are the original and twenty-five (25) copies of The Burlington Northern and Santa Fe Railway Company's Reply to Applicants' Petition to Establish Procedural Schedule (BNSF-1). Also enclosed is a disk with the text of the pleading in Word Perfect 9 format.

I would appreciate it if you would date-stamp the enclosed extra copy and return it to the messenger for our files. Please let me know if you have any questions. Thank you for your assistance.

Sincerely yours,

Adrian L. Steel, Jr.

Enclosures

cc: William A. Mullins, Esq.
Richard H. Streeter, Esq.
All Parties of Record

BNSF-1

BEFORE THE
SURFACE TRANSPORTATION BOARD



Finance Docket No. 34342

KANSAS CITY SOUTHERN
- CONTROL -
THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN
RAILWAY COMPANY, AND THE TEXAS MEXICAN RAILWAY COMPANY

THE BURLINGTON NORTHERN AND SANTA FE
RAILWAY COMPANY'S REPLY TO APPLICANTS'
PETITION TO ESTABLISH PROCEDURAL SCHEDULE

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Dated: June 3, 2003

BEFORE THE
SURFACE TRANSPORTATION BOARD

Finance Docket No. 34342

KANSAS CITY SOUTHERN
– CONTROL –
THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN
RAILWAY COMPANY, AND THE TEXAS MEXICAN RALWAY COMPANY

THE BURLINGTON NORTHERN AND SANTA FE
RAILWAY COMPANY'S REPLY TO APPLICANTS'
PETITION TO ESTABLISH PROCEDURAL SCHEDULE

The Burlington Northern and Santa Fe Railway Company ("BNSF") submits this reply to the Petition to Establish Procedural Schedule ("Petition") filed by Kansas City Southern ("KCS"), The Kansas City Southern Railway Company ("KCSR"), Gateway Eastern Railway Company ("Gateway Eastern"), and The Texas Mexican Railway Company ("Tex Mex") (collectively, "Applicants"). In their Petition, the Applicants request that the Surface Transportation Board ("Board") adopt an expedited four month procedural schedule which would provide parties with less time (61 days from the filing of the Application) to conduct discovery and prepare comments than in either of the Board's most recent "minor" control transactions¹ (both of which involved issues of less competitive significance, but which provided for 77 days for the filing of comments and requests for conditions).

¹ Dakota, Minnesota & Eastern R.R. et al. – Control – Iowa, Chicago & Eastern R.R. Corp., STB Finance Docket No. 34178 (Decision No. 2 served Sept. 26, 2002), at 17; Canadian National Ry. et al. – Control – Wisconsin Central Transportation Corp. et al., STB Finance Docket No. 34000 (Decision No. 2 served May 9, 2001), at 15.

However, as set forth below, the proposed transaction has potentially broad regional, national and international transportation significance, and the Applicants should be required to supplement the Application to address the full range of competitive and operational impacts the transaction will have, including specifically, their plans to cancel any Tex Mex or TFM S.A. de C.V. ("TFM") agreements or arrangements with other carriers once common control is achieved. By so doing, the Board will ensure that the Board, the shipping public, and the commenting parties can judge the full impacts of the transaction. The Applicants have not provided such information and data in their initial filing, and the public interest requires that they do so.

Because of the importance of the competitive issues raised by the proposed transaction, the procedural schedule should be extended by a modest amount to provide for at least a 45 day period from the supplementation of the Application for the filing of comments and requests for conditions. Further, should the Board determine that supplementation of the Application is not required, commenting parties should be afforded at least 60 days from the publication in the Federal Register of the acceptance by the Board of the Application to conduct discovery, analyze the relevant issues, and file their comments and requests for conditions.

I.

**THE PROPOSED PROCEDURAL SCHEDULE SHOULD BE MODIFIED
TO REQUIRE THE APPLICANTS TO SUPPLEMENT THE APPLICATION**

The Applicants themselves have described their proposed transaction as "one more step" in their efforts "to develop a 'NAFTA Railroad' that would connect Canada, the U.S., and Mexico and provide seamless, efficient, and competitive rail service in all of North America." Application at 10-11. Further, as shown in the Verified Statement of

David Reishus attached hereto ("Reishus V.S. at ____"), the transaction has the potential of affecting competition to and from Mexico via the Laredo and Brownsville gateways and of impacting the effectiveness of the conditions imposed by the Board on the 1996 UP/SP merger, including the trackage rights and other conditions imposed to enable BNSF to replace SP in the critical Mexican import/export rail market and elsewhere in South Texas.²

As Dr. Reishus states:

Creation of NAFTA Rail, through the common control of KCSR, Tex Mex and TFM, could significantly alter rail competition on a national and international scale. The combination will create an integrated rail system that reaches from Mexico City to the U.S. heartland and would, for the first time, place control of both sides of the crucial Laredo gateway under the control of a single transnational entity.

The first stage of the combination, the proposed common control of Tex Mex and KCSR, by itself alters the competitive structure of U.S. rail transportation to and from Mexico. It would remove Tex Mex as an independent interline carrier that provides competitive access to Laredo for both BNSF and KCSR. The behavior of a combined Tex Mex-KCSR with respect to BNSF may limit or reduce the competitive alternatives available to shippers across a broad geographic area.

Reishus V.S. at 3-4.

Notwithstanding the broad scope of these transportation effects,³ the Applicants assert that expedition is justified because there are no anticompetitive effects that will

² See Union Pacific/Southern Pacific Merger, 1 S.T.B. 233, 368, 409-10, 423 (1996). See also 1 S.T.B. at 565, where the Board recognized that BNSF would provide the "replacement for SP for Laredo traffic routed over Tex Mex." The Board itself has described Laredo as "the most important U.S.-Mexican rail gateway." Id. at 422.

³ Given these regional and national effects as well as the deficiencies in the Applicants' analysis of the competitive effects of the transaction described in this Reply and in Dr. Reishus's Verified Statement, it is uncertain whether the Applicants have "clearly" shown that the standards of 49 C.F.R. § 1180.2(b)(1) and (2) have been met and that the proposed transaction qualifies as a "minor" transaction under that section. In this
(cont'd)

result from the transaction. They do so on three principal grounds. First, relying on the Verified Statement of Dr. Curtis Grimm, they assert that there will be no loss of competitive rail options by any shipper or receiver and that there are no locations, stations, points or corridors that will see competitive options reduced from two-to-one nor would there be any three-to-two effects.⁴ Application at 17, 25 and 70-117. Second, they assert that the transaction is not anticompetitive because it does not "call for cancellation of any cooperative agreements with other carriers." Application at 26. Finally, the Applicants assert that the transaction will have no adverse impact on competition because it "occurs in a market where motor carriers are the dominant mode of transportation." Application at 27-28.

The Applicants' stated analysis of the competitive effects of the transaction can and will be tested through discovery and responsive testimony. As Dr. Reishus shows, their analysis is, however, significantly deficient and misleading in that it fails to address

(... cont'd)

regard, it should be noted that, when the Interstate Commerce Commission ("ICC") revised the definition of "significant" transactions in 1993 to adopt the current language set forth in 49 C.F.R. § 1180.2(b), it clarified its understanding of the term: "A non-major transaction that clearly satisfies the applicable substantive standard [of 49 U.S.C. § 11344(d)] lacks anything that might be categorized as significant." Ex Parte No. 282 (Sub-No. 17), Railroad Consolidation Procedures: Definition of, and Requirements Applicable to, "Significant" Transactions, 9 I.C.C.2d 1198, 1199 (1993) (emphasis added). BNSF does not, however, take a position as to whether the transaction is properly classified as a "minor" transaction as the Applicants have proposed and will leave to the Board the determination of whether the Applicants have made the requisite showing.

⁴ Dr. Grimm also concluded with virtually no analysis that there would be no loss of source or geographic competition. Application at 81-82.

several critical effects of the transaction.⁵ For instance, in his analysis of competition, Dr. Grimm assumed that the existing agreements that Tex Mex has with other carriers would continue in effect.⁶

However, while KCS did assert that it would not cancel any "cooperative agreements" with other rail carriers, KCS is referring to marketing agreements and alliances, such as the CN/IC/KCSR Alliance Agreement and the 2002 Marketing Agreement between KCSR and BNSF. See Application at 26-27, 59-60. KCS does not commit to the continuation of agreements between Tex Mex and other carriers which do not involve KCSR, such as those between BNSF and Tex Mex with respect to divisions of revenue on the Laredo to Robstown route. Specifically, KCS stated in the Application:

Because KCSR has been a minority investor in Tex Mex and because TFM and Tex Mex have been responsible for their own pricing and marketing arrangements, there may be some agreements that would not provide adequate revenues to a combined KCSR/Tex Mex system. It is KCSR's intention to honor all Tex Mex agreements upon taking common

⁵ In addition to the issues discussed in the text, the Applicants and Dr. Grimm have also failed to address the impact of the transaction on the CN/IC/KCSR Alliance Agreement and the extent to which Tex Mex and/or TFM would be subject to the agreement. The failure to do so is an independent basis for concluding that the Applicants have not fully identified and described all potential competitive effects.

⁶ Dr. Grimm's underlying assumption that the existing Tex Mex agreements would continue in place is echoed in the Verified Statement of Bengt Mutén where Mr. Mutén, who conducted the Applicants' traffic diversion analysis, stated that (i) "[a]ll contracts have been renewed or renegotiated (steady state)," and (ii) "[n]o other changes in the railroad system structure, ownership, or cooperative arrangements occur." Application at 119. The assumption is further supported at page 3 of the Petition where the Applicants argue that one of the reasons that their transaction will not lead to reduced competition is because of "the fact that other carriers have commercial agreements with KCSR and Tex Mex which protect their interests." Presumably, the Applicants would agree that, if those agreements do not remain in place, then the interests of the other carriers would not be protected, and there would be an effect on competition.

control, but any agreement that does not provide adequate revenues will be reviewed and, if necessary, cancelled pursuant to the terms of that agreement.

Application at 26, n.19. See also Verified Statement of Michael R. Haverty, Application at 60, n. 3:

There may be some agreements specific to Tex Mex and other carriers not involving KCSR that would not provide a combined KCSR/Tex Mex with sufficient revenues to cover costs. It is KCSR's intention to honor all agreements upon taking common control, but any agreement that does not provide enough revenues to cover costs, although honored under its terms, will, upon expiration, be renegotiated or not renewed.

While KCS has expressed its intention to "honor" all Tex Mex agreements upon common control, Dr. Grimm has not analyzed what the effect on competition would be if KCS cancelled those agreements, including the 1998 BNSF-Tex Mex agreement for the Laredo-Robstown route which expires in December 2003, as it has expressly reserved the right to do.

In addition, KCS's filing indicates its intention for BNSF to interchange Laredo traffic with KCSR at Kansas City rather than at Robstown/Corpus Christi and for eastern carriers to switch their interchanges for Mexico traffic from BNSF and UP to KCSR (at East St. Louis, Meridan, New Orleans, etc.). See Application at 122. KCS apparently intends to restrict BNSF access to Laredo and to have BNSF to short haul itself (or even lose traffic to different interchanges) regardless of whether doing so would result in less efficient and less competitive service to shippers.

As explained in its filing, KCS's plans could therefore significantly undercut BNSF's ability to provide competitive SP replacement service to/from Mexico and south Texas. As Dr. Reishus concludes, "[t]he competitive alternative to UP at Laredo provided by BNSF and Tex Mex may be threatened if KCS cancels or fails to renew the

existing economic and operational agreements that govern the BNSF-Tex Mex relationship." Reishus V.S. at 4-5. See also Reishus V.S. at 6 ("The conditions imposed by the Board on the UP/SP merger to provide replacement competition for SP depend on BNSF and Tex Mex working cooperatively to provide a competitive alternative at commercially reasonable rates."). Moreover, if BNSF cannot cost effectively provide that service, it will need to consider moving the traffic (such as grain) to other markets. BNSF's traffic density would also be jeopardized, and BNSF might be unable to provide the frequency of service needed to effectively compete with UP.

Dr. Grimm also failed to address the issue of the impact on competition that would result (i) from KCS's simultaneous acquisition of TFM, and (ii) from TFM's ability (once under KCS's control and direction) to refuse to continue to provide neutral, non-discriminating rates and services at Laredo and Brownsville. For instance, TFM could, by refusing to provide BNSF and UP with commercially viable divisions or rates to and from points in Mexico to the border gateways, very significantly affect the import/export rail market. In addition, KCS will have control over the International Bridge at Laredo, providing it with another opportunity to favor its carriers to the detriment of other carriers.

As Dr. Reishus describes:

Control of TFM will extend NAFTA Rail's influence beyond the BNSF gateways with Tex Mex to the significant easternmost U.S.-Mexico gateways of Laredo and Brownsville. Control of TFM would provide NAFTA Rail the unique opportunity to set rates and operating conditions over these gateways in a potentially discriminatory manner that favors itself and raises the costs to competitors in an anticompetitive fashion. The competitive routings at risk include UP through the Laredo and

Brownsville gateways, BNSF through the Brownsville gateway, and BNSF-Tex Mex interline service through the Laredo gateway.

Reishus V.S. at 8.⁷

The possibility of action by KCS and TFM limiting competitive options is not merely hypothetical. The Applicants have themselves noted that, by removing Grupo TMM's influence over TFM, the proposed common control will eliminate the "sometimes contradictory marketing and operating goals being pursued by KCS and TMM." Application at 30. In other words, KCS intends to use its newly-acquired control to change Tex Mex's and TFM's behavior that KCS believes is contrary to its interests. Yet, there is nothing in the Application whatsoever about these intended effects.

KCS's failure to address the consequences which would result from its plans to cancel or terminate certain agreements and to utilize its control over Tex Mex and TFM to its own private benefit stands in stark contrast to the positions it forcefully took before the Board in Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures. There, in addition to contending that all rail service options should be preserved in future merger proceedings and that mergers are not necessary to achieve efficiencies, KCS argued that "full disclosure of all the aspects affecting or being affected by [a] merger" is the "best way" to evaluate the benefits of a proposed merger and that there should be "full disclosure of both the potential benefits and harms of a merger." Comments of The Kansas City Southern Railway Company, Ex Parte No. 582 (Sub-No.

⁷ Dr. Reishus also notes that "[d]ifferences in U.S. and Mexican regulatory policy and commercial behavior have led to unanticipated results that affect U.S.-Mexico rail transportation and the resulting competitive outcomes in the U.S." Reishus V.S. at 9. Accordingly, he suggests that the Board should evaluate the impact that the Mexican regulatory system will have on competition to and from Mexico and at border gateways.

1) (filed November 17, 2000), at 14. Given the patent deficiencies in the Application discussed above, KCS seems to have lost its fervent interest in "full disclosure."

Therefore, the Board should not permit the proceeding to continue without requiring the Applicants to supplement the Application to provide information on the potential competitive effects described above concerning the Tex Mex and TFM agreements and arrangements. That information is required under Section 1180.6(a)(2) which is applicable to all transactions and which requires a "detailed discussion" of the "effect of the transaction on inter- and intramodal competition," including a discussion of whether there "is likely to be any lessening of competition."

Specifically, the Applicants should be instructed to include the following as a part of the additional information they submit:

- Identification of all marketing, operations, division of revenue or other agreements and arrangements which Tex Mex has with other carriers (including KCSR and TFM), whether KCS intends to continue each such agreement or arrangement after common control is acquired, and, if not, the impact on competition, the UP/SP merger conditions and the public interest that the discontinuance of each such agreement or arrangement will have.
- Identification of all marketing, operations, division of revenue or other agreements and arrangements which TFM has with other carriers (including KCSR and Tex Mex), whether KCS intends to continue each such agreement or arrangement after common control is acquired, and, if not, the impact on competition, the UP/SP merger conditions and the public interest that the discontinuance of each such agreement or arrangement will have.

The submission of such information is critical to a full and fair examination by shippers, other parties and the Board of the Applicants' proposed transaction.⁸ The Board's

⁸ The time during which KCS is preparing the information would not count against the statutory 180 day period for Board action (i.e., the proceeding would be tolled or (cont'd)

regulations provide for the submission of "such additional information to support [the] application as the Board may require" (49 C.F.R. § 1180.4(c)(2)(v)), and the Board and its predecessor ICC have required supplementation in the past when necessary to enable the agency to evaluate fully the effects of a proposed transaction. See, e.g., Union Pacific Corp., Union Pacific R.R. & Missouri Pacific R.R. Co. – Control – Missouri-Kansas-Texas R.R. Co., ICC Finance Docket No. 30800 (Decision No. 6 served Oct. 24, 1986), at 4-5, where the ICC required the applicants to supplement their application to provide, inter alia, additional information on the competitive impacts of the proposed transaction, including "proof to support any allegation that competition won't be reduced" and "evidence on the impact of the consolidation on the competitive alternatives of shippers."⁹ The Board should do likewise here.

II.

THE PROPOSED PROCEDURAL SCHEDULE SHOULD BE EXTENDED

The Applicants have proposed a procedural schedule that would result in a final Board decision within four months of the filing of the Application – a period which is two months shorter than the maximum six month period set forth in the statute for "minor"

(... cont'd)

suspended during that period), and comments and requests for conditions would be due at least 45 days after the supplemental materials are submitted. This would allow the Board to meet the statutory deadlines.

⁹ See also, e.g., CSX Corp. & CSX Transportation, Inc., Norfolk Southern Corp. & Norfolk Southern Ry. – Control & Operating Leases/Agreements – Conrail Inc. & Consolidated Rail Corp., STB Finance Docket No. 33388 ("CSX-NS-Conrail") (Decision No. 44 served Oct. 15, 1997) (requiring applicants to submit supplemental operating plan information); CSX-NS-Conrail (Decision No. 19 served Aug. 7, 1997) (requiring applicants to submit supplemental information concerning proposed train schedules).

transactions. The proposed schedule is deficient in two major respects whether or not supplementation of the Application is required.

First, the time period for submitting comments and requests for conditions does not provide interested parties with adequate time to investigate, analyze and develop their positions with respect to the effects on competition discussed above. There will need to be discovery on a number of critical issues in order to determine exactly what KCS's plans are. For instance, as discussed above, the Board and the parties are entitled to know precisely which Tex Mex and TFM agreements and arrangements KCS plans to cancel after common control. The Board and parties are also entitled to know exactly what TFM plans to do with respect to providing rates and service to UP and BNSF at Laredo and Brownsville after common control is acquired. KCS's failure to address these issues in its Application evidences that a significant amount of discovery will need to be conducted.¹⁰ Second, the proposed schedule unnecessarily limits the

¹⁰ BNSF has already served its first set of interrogatories and document requests on the Applicants. BNSF will need time to review the Applicants' responses, file supplemental requests (if necessary), and take the depositions of the Applicants' expert and other witnesses in order to understand and respond to their assertions and analyses. In this regard, KCS's and Tex Mex's limited responses to BNSF's first set of discovery requests (which were served on June 2, 2003) indicate that discussions with KCS and Tex Mex will be required in order to secure full responses, and BNSF may need to consider whether or not to pursue a motion to compel with the Board. For instance, both KCS and Tex Mex have taken the position in their responses that they will not produce drafts of contracts or agreements, any information or documents related to the negotiation of any agreements, and any documents or information related to TFM or TMM. These objections are not supported by any Board precedent, but it will nonetheless require additional time to resolve these disputes.

Further, the Applicants cannot avoid their obligation, as set forth above, to provide the information on the Tex Mex and TFM agreements and arrangements described above on the grounds that the information can be obtained through discovery. As the applicants in this proceeding, the Applicants bear the responsibility of identifying all competitive effects and providing an analysis of those effects. See 49 C.F.R. § (cont'd)

time that the Board has to consider and analyze the proposed transaction. As can be seen from the numerous issues that will arise, it would be contrary to the public interest for the Board to establish a procedural schedule shorter than the maximum time permitted by statute.¹¹

The Applicants have provided only limited justification for an expedited schedule in a transaction that would already be handled under an abbreviated schedule as a "minor" transaction. The Applicants argue that expedition is needed to "release Tex Mex from its current status of being in a voting trust" and that minimizing the time Tex Mex needs to be in a voting trust is "a noble goal." Petition at 4. However, it was KCS that voluntarily chose to place Tex Mex in a voting trust just days before the Application was filed, and, absent a justification for doing so, the Applicants cannot be permitted to bootstrap a need for expedition where they themselves artificially created the "need."

Further, because, as the Applicants have noted, there is already a "close working relationship" between KCSR and Tex Mex and a significant degree of integration and coordination between KCSR's and Tex Mex's activities such that "a strong argument could be made that KCSR and Tex Mex already constitute a single-system" (Application

(... cont'd)

1180.6(a)(2). They cannot shirk that responsibility and seek to cast it on the responding parties. See also 49 C.F.R. § 1180.4(c)(8) which requires that applicants present a prima facie case in their application.

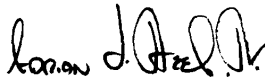
¹¹ If the Board determines that supplementation of the Application is not required, commenting parties should be afforded at least 60 days from the publication in the Federal Register of the acceptance by the Board of the Application to conduct discovery, analyze the relevant issues, and file their comments and requests for conditions.

at 16), there is no need to rush to judgment. The large majority of the efficiencies and synergies are already being achieved.

CONCLUSION

For the foregoing reasons, the Board should require the Applicants to supplement the Application with the information specified herein concerning the Tex Mex and TFM agreements and arrangements, and the proposed procedural schedule should be extended to provide that comments and requests for conditions are due at least 45 days after the supplemental materials are submitted. If supplementation is not required, commenting parties should be afforded at least 60 days from the publication in the Federal Register of the acceptance by the Board of the Application to file their comments and requests for conditions.

Respectfully submitted,



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Attorneys for The Burlington Northern and Santa Fe Railway Company

Dated: June 3, 2003

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by hand or first class mail
this 3rd day of June, 2003, on all parties of record in Finance Docket No. 34342.



**BEFORE THE
SURFACE TRANSPORTATION BOARD**

FINANCE DOCKET NO. 34342

**KANSAS CITY SOUTHERN
-- CONTROL --
THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY,
and
THE TEXAS MEXICAN RAILWAY COMPANY**

**VERIFIED STATEMENT OF
DAVID REISHUS**

QUALIFICATIONS AND PURPOSE

My name is David Reishus, and I am a Senior Vice President at Lexecon Inc., and prior to its acquisition by Lexecon in 1999 was President of The Economics Resource Group, Inc. I received my Ph.D. (1988) and Master's (1983) degrees in economics from Harvard University.

I have specialized in applied microeconomic analysis and have consulted for numerous private and public clients on issues involving the economics of competition, pricing, market access, mergers, and regulation. I have worked extensively in the railroad and energy sectors, and have previously filed testimony before regulatory bodies on the operation of markets and competition. I have submitted testimony to the Surface Transportation Board ("STB" or "Board") on Competition and Rail Access. My curriculum vitae is attached as Appendix 1.

I have been asked by The Burlington Northern and Santa Fe Railway Company ("BNSF") to review the application in this proceeding with respect to the potential competitive impacts if the transaction were

approved and to assess the extent to which these concerns have been addressed in the application.¹

COMPETITIVE SCOPE OF THE PROPOSED TRANSACTION

Kansas City Southern ("KCS") announced a series of agreements that would combine The Kansas City Southern Railway Company ("KCSR"), The Texas Mexican Railway Company ("Tex Mex"), and TFM, S.A. de C.V. ("TFM") as wholly owned subsidiaries under the common control of KCS, to be renamed NAFTA Rail.² The first stage of the proposed combination, which is the subject of this proceeding, involves the common control of KCSR and Tex Mex by KCS.³ The second stage of the proposed combination entails exchanging cash and stock so that TFM, which owns among other lines the rail lines from Laredo and Brownsville to Monterey and Mexico City, will be wholly owned and controlled by KCS.

Tex Mex is the only rail carrier besides Union Pacific Railroad ("UP") with access to the Laredo gateway with Mexico. Laredo is the dominant gateway to Mexico, accounting for 75% of the value of rail trade with the country.⁴ UP is the largest carrier at Laredo, accounting for almost 85% of the units passing through the Laredo gateway. BNSF-Tex Mex routings have the next largest volume, with KCSR-Tex Mex as the smallest-volume alternative.⁵

¹ Railroad Control Application, Finance Docket No. 34342, Kansas City Southern -- Control -- The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company, May 14, 2003 ("KCS Application").

² I will refer to KCS, KCSR, Tex Mex, and The Gateway Eastern Railway Company (a 17-mile short line wholly owned by KCSR) as the "Applicants."

³ KCS has already acquired ultimate ownership of Tex Mex (via MexRail) and is seeking approval to exercise control of Tex Mex and dissolve the voting trust into which it has been placed.

⁴ U.S. Port Report by Rail, 2001, U.S. Department of Transportation, Bureau of Transportation Statistics, http://www.bts.gov/ntda/tbscd/reports/annual01/port/pt_2001_ral.html.

⁵ V.S. of Curtis Grimm, KCS Application at 113 and 114.

In the UP/Southern Pacific ("SP") merger, the Board conditioned the merger approval on, among other things, BNSF's trackage rights over former SP lines that permitted interchange with Tex Mex at Robstown and Corpus Christi to obtain access to Laredo. The Board expressed concern that Tex Mex would retain sufficient traffic base after the merger to continue to provide a second competitive routing at Laredo. Although the Board clearly anticipated that BNSF alone and through interline service with Tex Mex would provide effective competition to and from Mexico, it provided a third competitive option via a Tex Mex-KCSR routing.⁶ The STB concerns regarding Tex Mex losing traffic volume -- one explanation for providing interchange with KCSR -- proved unwarranted, as traffic on Tex Mex has nearly tripled since 1995, and current BNSF interchange volume alone exceeds total Tex Mex traffic in 1995.⁷

Creation of NAFTA Rail, through the common control of KCSR, Tex Mex and TFM, could significantly alter rail competition on a national and international scale. The combination will create an integrated rail system that reaches from Mexico City to the U.S. heartland and would, for the first time, place control of both sides of the crucial Laredo gateway under the control of a single transnational entity.

The first stage of the combination, the proposed common control of Tex Mex and KCSR, by itself alters the competitive structure of U.S. rail transportation to and from Mexico. It would remove Tex Mex as an independent interline carrier that provides competitive access to Laredo for both BNSF and KCSR. The behavior of a combined Tex Mex-KCSR

⁶ Surface Transportation Board, Finance Docket No. 32760, Union Pacific Corporation, Union Pacific Railroad Company, and Missouri Pacific Railroad Company -- Control and Merger -- Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp., and The Denver and Rio Grande Western Railroad Company, Decision No 44, August 6, 1996 at 147-151.

⁷ V.S. of James L. Riney, KCS Application at 133.

with respect to BNSF may limit or reduce the competitive alternatives available to shippers across a broad geographic area. The diversion study presented by the Applicants indicates that they anticipate traffic ranging from New England, Canada and the Pacific Northwest will be affected by the proposed transaction and will also result in traffic being diverted across different Mexican gateways.

As the Board stated in the UP/SP merger, "We are particularly sensitive to our responsibility to ensure that this merger will foster the goal of North American economic integration embodied in NAFTA."⁸ Such special emphasis about ensuring efficient and affordable transportation in international trade is sound public policy when engaging in merger review. As with the UP/SP merger, it is appropriate to consider the scope and competitive impact of the proposed transaction on access to foreign markets and international trade.

COMPETITIVE EFFECTS OF THE PROPOSED TRANSACTION

Both the proposed common control of KCSR and Tex Mex and the further transaction with TFM are classic end-to-end combinations. Such end-to-end transactions generally demonstrate little or no loss of horizontal competition as there is little or no geographic overlap. Once it is shown there is no loss of source competition, few anticompetitive concerns typically remain. However, the special circumstances of this proposed transaction make its competitive impact much less clear and require a more detailed examination.

The competitive alternative to UP at Laredo provided by BNSF and Tex Mex may be threatened if KCS cancels or fails to renew the existing economic and operational agreements that govern the BNSF-Tex Mex relationship. These agreements were initially struck following the UP/SP

⁸ Surface Transportation Board, Finance Docket No. 32760, Union Pacific/Southern Pacific Merger, Decision No 44, August 6, 1996, at 147.

merger as a means to coordinate activity between Tex Mex and BNSF to compete with UP over Laredo. The main agreement negotiated in 1998 is scheduled to expire at the end of this year.

KCS indicated that it would not cancel any "cooperative agreements" with other rail carriers.⁹ This commitment does not appear to extend to the BNSF-Tex Mex agreements. As stated by the Applicants:

Because KCSR has been a minority investor in Tex Mex and *because TFM and Tex Mex have been responsible for their own pricing and marketing arrangements*, there may be some agreements that would not provide adequate revenues to a combined KCSR/Tex Mex system. It is KCSR's intention to honor all Tex Mex agreements upon taking common control, but any agreement that does not provide adequate revenues will be reviewed and, if necessary, cancelled pursuant to the terms of that agreement. (KCS Application at 26-27, n. 19. Emphasis added.)

Moreover, the proposed CEO of NAFTA Rail states:

There may be some agreements specific to Tex Mex and other carriers not involving KCSR that would not provide a combined KCSR/Tex Mex with sufficient revenues to cover costs. It is KCSR's intention to honor all agreements upon taking common control, but any agreement that does not provide enough revenues to cover costs, although honored under its terms, will, upon expiration, be renegotiated or not renewed. (V. S. of Michael R. Haverty, KCS Application at 60, n. 3)

As Tex Mex's largest interline partner, BNSF is the economically relevant target of these refusals to commit to continue the existing agreements.

Thus, it is clear that the proposed combination could potentially harm BNSF's ability to compete against UP for traffic to and from Mexico through Laredo. To the extent that the BNSF-Tex Mex routing provides effective competition that constrains UP's ability to raise rates, then actions by the combined KCS that reduce or eliminate the competitive

⁹ KCS Application at 26.

discipline provided by BNSF-Tex Mex could harm shippers and may be anticompetitive. The conditions imposed by the Board on the UP/SP merger to provide replacement competition for SP depend on BNSF and Tex Mex working cooperatively to provide a competitive alternative at commercially reasonable rates.

It does not appear that the diversion and competition analyses in the KCS Application have incorporated the likelihood of KCS altering the existing commercial relationships between Tex Mex and BNSF. Tex Mex is treated as a bottleneck carrier, and no attempt has been made to evaluate the effect of the existing relationship and any changes to that relationship that might result from the transaction. Dr. Grimm does not appear to account for the change in commercial access to Tex Mex contemplated by KCS.

The diversion study conducted by Mr. Mutén and utilized by Dr. Grimm in his competitive analysis is not clearly explained and does not appear to be consistent with a prospective change in the relationship between Tex Mex and BNSF. The assumptions listed for the diversion study include:¹⁰

- All contracts have been renewed or renegotiated (steady state).
- No other changes in the railroad system structure, ownership, or cooperative arrangements occur.

Moreover, the sole explanation for the “Estimate of expected diversions” consists of the statement: “The diversion rules are applied to find a diversion percentage for each accepted candidate route.”¹¹ The diversion rules are not otherwise identified or explained. As such, it is unclear what economic factors drive the diversion results utilized by Dr. Grimm in his competitive analysis.

¹⁰ V. S. of Bengt Mutén, KCS Application at 119.

¹¹ V. S. of Bengt Mutén, KCS Application at 121.

As the diversion study is based on the 2001 Waybill Sample, during which the existing BNSF-Tex Mex agreement was in effect, the study would appear to ignore the impact of the cancellation, expiration, or revision of the BNSF-Tex Mex agreement. A preliminary review of the diversion study detail indicates that the study predicts a variety of BNSF traffic headed to or from Brownsville and to or from Laredo over the Corpus Christi and Robstown gateways with Tex Mex is diverted to the commonly controlled carrier. Approximately two-thirds of the total revenue gained by the combined KCSR-Tex Mex from BNSF arises from diversions predicted to interchange with KCSR at Kansas City rather than over the BNSF-Tex Mex gateways or served by BNSF in single-line service to Mexico and South East Texas.

For those traffic routings involving BNSF that are predicted to be diverted as a result of KCSR-Tex Mex common control, less than a quarter of the traffic on those routes on average are predicted to be diverted. These predictions appear to be the result of some assigned probability that the commonly controlled KCSR-Tex Mex would attract business from BNSF-Tex Mex under the existing commercial relationships. The remaining approximately three-quarters of the traffic on these divertible routes that is not diverted is predominantly predicted to flow over BNSF and interline with Tex Mex. This result, however, is inconsistent with the reservations and representations of KCS to not renew the Tex Mex-BNSF agreements, which indicate that KCS intends to divert BNSF-Tex Mex traffic through Kansas City, to the extent that makes sense to KCS.

If the studies relied on by the Applicants for analyzing competitive effects of the transaction assume no change in the commercial relationship between BNSF and Tex Mex, then these studies would only be applicable in the situation that the commercial relationships remain unchanged. If the Applicants do not intend to maintain the existing

commercial agreements between BNSF and Tex Mex, then the diversion study fails to reflect the proposed transaction. Further, if KCS intends to short-haul BNSF on all divertible BNSF-originated traffic to Kansas City, then it has grossly understated the impact of the proposed transaction on BNSF's competitive traffic to and from Mexico and on BNSF's ability to provide the competitive replacement for SP intended by the Board in the UP/SP merger conditions.

FURTHER COMPETITIVE EFFECTS OF THE INTENDED TRANSACTION

The intended integration of TFM, the highest volume rail carrier in Mexico, into NAFTA Rail raises additional issues in evaluating the competitive impact of common control of Tex Mex and KCSR. TFM is currently under independent control from U.S. carriers and would appear to have the incentive and strategy of not discriminating among U.S. carriers as it attempts to attract traffic to its system. Control of TFM will extend NAFTA Rail's influence beyond the BNSF gateways with Tex Mex to the significant easternmost U.S.-Mexico gateways of Laredo and Brownsville. Control of TFM would provide NAFTA Rail the unique opportunity to set rates and operating conditions over these gateways in a potentially discriminatory manner that favors itself and raises the costs to competitors in an anticompetitive fashion. The competitive routings at risk include UP through the Laredo and Brownsville gateways, BNSF through the Brownsville gateway, and BNSF-Tex Mex interline service through the Laredo gateway.

If NAFTA Rail were to increase the share of traffic utilizing a KCSR-Tex Mex routing at Laredo, it might on the surface appear to be pro-competitive by decreasing the share of traffic carried by the larger carriers. If, however, this change arises due to inefficient and discriminatory rates or conditions that raise UP's or BNSF's costs, then

the outcome is the result of anticompetitive behavior that harms U.S. shippers.

While the creation of NAFTA Rail is anticipated to occur in two steps, there has been no analysis presented in the KCS Application of the competitive issues posed by a commonly controlled Tex Mex-KCSR as part of a larger NAFTA Rail system. Concerns about inefficient and discriminatory rates and conditions resulting from common control of Tex Mex and KCSR may be amplified many times when control of TFM is obtained in the second stage of the intended transaction.

The common control of KCS and Tex Mex with TFM will be subject to Mexican regulatory oversight for which different standards apply, and the outcome of this approval process is uncertain. Results of Mexican rail regulation directly affect the competitive alternative of U.S. shippers. Problems of excessive trackage charges, unresolved access issues, and other difficulties have plagued post-privatization Mexican rail regulation. While an improvement over state ownership, the Mexican regulatory outcomes have frequently not met expectations about a competitive Mexican rail industry. Differences in U.S. and Mexican regulatory policy and commercial behavior have led to unanticipated results that affect U.S.-Mexico rail transportation and the resulting competitive outcomes in the U.S.

It is not apparent what regulatory recourse U.S. shippers may have regarding potential inefficient and discriminatory treatment by a NAFTA Rail-controlled TFM. Rates quoted by TFM to and from points in Mexico to the U.S. gateways presumably would be subject to Mexican, rather than U.S., regulatory authority. If NAFTA Rail utilized such discriminatory conduct to favor Tex Mex-KCSR traffic to the detriment of U.S. shippers, absent merger conditions in this first-stage transaction, such shippers may only have recourse to Mexican regulatory relief.

In the absence of any analysis of the requirements and restrictions on the behavior of the Mexican portion of an integrated U.S.-Mexican rail system that controls the Laredo and Brownsville gateways and the most efficient route to Monterey and Mexico City, conclusions regarding the competitive impacts of this first stage of the transaction – common control of Tex Mex and KCSR – are speculative. The Board needs to understand the implications of common control of TFM with Tex Mex and KCSR, the nature of Mexican rail regulation, and the incentives and restrictions applicable on the TFM portion of NAFTA Rail.¹²

¹² Under the STB's revised procedures for Major Rail Consolidations, the Board requires applicants in transnational transactions to submit competitive analyses and operating plans for the "full system," including parts of the system that do not fall under the STB's jurisdiction. STB Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures (served June 11, 2001).

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PROFESSIONAL EXPERIENCE

Lexecon Inc., Cambridge, MA
(successor to The Economics Resource Group, Inc.)
Senior Vice President, July 1999 - present

The Economics Resource Group, Inc., Cambridge, MA
President, 1993 - June 1999
Senior Economist, 1990 - 1993

Provides economic analysis and advice on issues of regulation, antitrust, taxation and applied microeconomics to a variety of clients. Develops, manages, and oversees economic analyses for clients and other principals. Responsible for the management and operations of the company.

U.S. Congress, Joint Committee on Taxation, Washington, DC
Economist, 1987 - 1990

Provided economic analysis and development of legislative tax proposals. Responsibilities included corporate and foreign taxation and proposals related to low-income taxpayers, child care, and health issues.

Harvard University, Cambridge, MA
Instructor, 1986 - 1987

Leader of senior thesis tutorial for industrial organization and finance topics. Previously taught Introductory Economics.

Information Resources, Inc., Chicago, IL
Consultant, 1979 - 1980

EDUCATION

Harvard University, Cambridge, MA
Ph.D. in Economics, 1988
Dissertation: "Empirical Essays on the Economics of Taxation and the Firm"

A.M. in Economics, 1983

Northwestern University, Chicago, IL

B.A. in Economics, 1979

TESTIMONY AND OTHER REPORTS

Dynegy Inc.

United States of America, Before the Federal Energy Regulatory Commission, San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, Investigation of Practices of the California ISO and PX; Pub. Utils. Comm'n of the State of California v. Sellers of Long-Term Contracts. Prepared Rebuttal Testimony (with Patrick Wang), March 20, 2003.

Duke Energy Trading and Marketing LLC

United States of America, Before the Federal Energy Regulatory Commission, San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange; Investigation of Practices of the California Independent System Operator and the California Power Exchange. Prepared Rebuttal Testimony (with Patrick Wang), March 20, 2003.

Dynegy Inc.; Duke Energy Services LLC; Mirant Americas, Inc.; Reliant Energy; Williams Energy Marketing and Trading Co.

United States of America, Before the Federal Energy Regulatory Commission, San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange; Investigation of Practices of the California Independent System Operator and the California Power Exchange. Affidavit (with Patrick Wang), October 15, 2002 (revised November 12, 2002), analyzing natural gas transactions for California delivery points during the October 2000 through June 2001 period encompassed by the California Refund Proceeding.

American Association of Railroads

Review of Rail Access and Competition Issues (with Joseph P. Kalt), March 26, 1998, *Before the Surface Transportation Board, Ex Parte No. 575.* Joint Verified Statement evaluating the economic effect of existing regulation on U.S. railroads and analyzing the implications of competitive access regulation.

Large International Petroleum Company

Preliminary Report in Response to an IRS Report (with Joseph P. Kalt), August 8, 1997, and *Preliminary Report Concerning the Value of a Business Opportunity* (with Joseph P. Kalt), September 12, 1997. Reports in connection with IRS internal appeals process.

Crow Tribe of Indians

Report Concerning the Crow Tribe Resort Tax (with Joseph P. Kalt), November 27, 1996; *Surrebuttal Report Concerning the Crow Tribe Resort Tax* (with Joseph P. Kalt), February 25, 1997; and *Report Concerning the Crow Tribe Resort Tax* (with Joseph P. Kalt), March 31, 2000. Reports analyzing the economic relationship of proposed resort tax and tribal spending activities on reservation economy in connection with *Rose vs. Adams* in the Crow Tribal Court, Montana.

Sithe Energies

Economic Impact on New York State of the Sithe Plan, Chapter IV of *Energizing New York: The Sithe Plan*, December 8, 1995. Report analyzing the regional economic impact of electric and gas restructuring proposals.

Massachusetts Department of Environmental Protection

Use of an Economic Test for Distinguishing Legitimate Recycling Activities, July 1993. Report for Department's use in analyzing the licensing of proposed hazardous waste recycling facility.

SELECTED OTHER CONSULTING EXPERIENCE

Amoco

Analyzed marketability and market value of natural gas for purposes of royalty valuation.

Class 1 Railroad

Analyzed claims of vertical market foreclosure and anticompetitive conduct in rail transportation.

Government of Canada

Assisted in analysis of changes in forestry practices and stumpage charges in the context of international trade agreements.

Exxon Corporation and Affiliated Companies (Miller & Chevalier)

Performed analysis of design and effect of U.K. oil and gas tax system.

CSX Corporation and CSX Transportation, Inc.

Analyzed historical evidence of rail consolidations and the impact of the proposed Conrail transaction on Eastern coal shippers. Evaluated competitive requirements of proposed conditions on the transaction.

Group of Major Oil Companies

Developed and analyzed a database of crude oil purchases for analyzing issues of crude oil valuation at the wellhead.

Koch Pipeline

Assisted in developing product and market definitions relating oil pipeline antitrust allegations.

British Petroleum

Performed economic analysis of alternative organizational forms for operating petroleum assets. Developed advanced financial tools for valuing decision alternatives and contingent assets.

Exxon (McGinnis & Lochridge)

Performed economic analysis of certain fuel used and cost allocations among the Prudhoe Bay Unit owners for a royalty dispute with the State of Alaska.

Burlington Northern Railroad/Santa Fe Railroad (Steptoe & Johnson/Mayer, Brown & Platt)

Analyzed competitive impacts of proposed railroad merger for use before the Interstate Commerce Commission.

Texaco (Thompson & Knight)

Analyzed crude oil pricing in international markets for Internal Revenue Service transfer pricing dispute.

PSI/CINergy

Adapted economic model of regional economy and performed analysis of the economic impact of alternative merger scenarios for a public utility.

El Paso Natural Gas Company (Gibson, Dunn, & Crutcher)

Performed economic analysis of markets and competition for an open-access natural gas pipeline for use in an antitrust case.

Better Home Heat Council, Inc. (Verner, Liipfert, Bernhard, McPherson and Hand)

Performed economic analysis of a local gas utility's conservation programs effect on consumer fuel-switching decisions and public policy impact for use before the Massachusetts Department of Public Utilities.

Association of American Railroads

Analyzed the impact of market conditions for the exemption of rail transportation of export corn and soybeans from Interstate Commerce Commission regulation.

ARCO Pipe Line Company (Steptoe & Johnson)

Evaluation of market power of petroleum products pipeline in consideration of light-handed regulation for use before the Federal Energy Regulatory Commission.

BP/America (Squire, Sanders, and Dempsey)

Assisted in the design and implementation of crude oil valuation analyses for royalty litigation.

Williams Natural Gas Pipeline Co. (Skadden, Arps, Slate, Meagher, & Flom)

Prepared pricing analysis of natural gas purchase contracts, performed calculation of damages, and analyzed economic submissions for use in antitrust case.

Government of British Columbia (Miller and Chevalier)

Assisted in evaluation of impact of Canadian log export regulations on U.S. and Pacific Rim log and wood products trade and industry.

Atlantic Richfield Company (Arnold & Porter)

Provided economic analysis of market structure and conduct for the distribution of motor fuels for use in an antitrust case.

Burlington-Northern Railroad (Steptoe & Johnson)

Assisted in evaluating market impacts of innovative railroad grain car service rate and reservation policy for use before the Interstate Commerce Commission.

National Cattleman's Association

Researched and wrote report analyzing the welfare and environmental effects of domestic U.S. beef production with particular concern about appropriate policy responses.

PUBLICATIONS AND RESEARCH

"Corporate Reorganizations: Tax Treatment of Corporate Mergers, Acquisitions, and Reorganizations," *The Encyclopedia of Taxation and Tax Policy*, The Urban Institute Press, 1999.

"Outside Directorships, the Reputation of Managers, and Corporate Performance" (with S. Kaplan), *Journal of Financial Economics*, Vol. 27, No. 2, September 1990.

"Financing Child Care: Who Will Pay for the Kids?," *National Tax Journal*, Vol. XLII, No. 3, September, 1989.

"The Effects of Taxation on the Merger Decision" (with A. Auerbach), in A. Auerbach, ed., *Corporate Takeovers: Causes and Consequences*, University of Chicago Press, 1988.

"Taxes and the Merger Decision" (with A. Auerbach), in J. Coffee, L. Lowenstein, and S. Rose-Ackerman, eds., *Knights, Raiders and Targets*, Oxford University Press, 1988.

"The Impact of Taxation on Mergers and Acquisitions" (with A. Auerbach), in A. Auerbach, ed., *Mergers and Acquisitions*, University of Chicago Press, 1988.

OTHER PROFESSIONAL ACTIVITIES

Presentations to National Bureau of Economic Research, Federal Reserve Bank of Cleveland, Federal Reserve Bank of New York, Harvard University, Tax Economists Forum, National Tax Association, Western Economic Association

Memberships in National Tax Association, American Economic Association

Referee for *Quarterly Journal of Economics*, *Journal of Law and Economics*

HONORS AND AWARDS

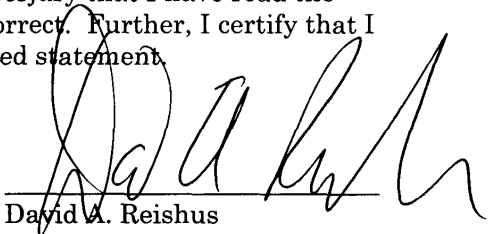
National Science Foundation Fellowship, 1981-1985

International Foundation of Employee Benefit Plans, Graduate Research Fellowship, Year 1984

Phi Beta Kappa, 1979

VERIFICATION

I, David A. Reishus, verify under penalty of perjury that I have read the foregoing statement and that it is true and correct. Further, I certify that I am qualified and authorized to file this verified statement.



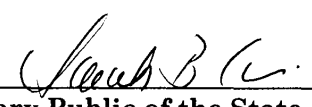
David A. Reishus

STATE OF MASSACHUSETTS)

) ss.

COUNTY OF MIDDLESEX)

Subscribed and sworn to before me
this 27th day of May 2003.



Notary Public of the State of Massachusetts

My commission expires: 12/15/08